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IN THE

Supreme Court of the United States

October Term, 1945.

No. 1065

FIRST NATIONAL BENEFIT SOCIETY, a Corporation,

Petitioner,

vs.

W. P. STUART, Collector of Internal Revenue for the District of Arizona,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

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Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Supreme Court of the United States:

The Petition of the First National Benefit Society, an Arizona Corporation, praying the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit, respectfully represents and shows:

I.

Summary Statement.

Petitioner was plaintiff in the United States District Court for the District of Arizona, and appellant in the United States Circuit Court of Appeals for the Ninth Circuit.

This case involves the validity of Federal Income Taxes and delinquency penalties assessed against petitioner for

the calendar year, 1938, in the total sum of $1914.05, which is determined by the question as to whether or not petitioner was a Life Insurance Company under the provisions of Section 201 (a) of the Internal Revenue Code. The said Section reads as follows:

> "When used in this title the term 'Life Insurance Company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined, life, health, and accident insurance) the reserve funds of which held for the fulfillment of such contracts comprise more than fifty percentum of its total reserve funds."

If appellant was such an insurance company during the year 1938, then under the provisions of Section 203 of said Internal Revenue Code, it would have been taxed only upon its investment income, that is, "interest, dividends, and rents" while respondent actually taxed petitioner upon its addition to its reserves.

Subsequent to the enactment of the above statute the Treasury Department Regulation 94, Articles 201 (a)-1 and 203 (a) 2-1 defined the term "reserves held for the fulfillment of such contracts" as "reserves required by state law and reserves calculated on some definite or adopted table of mortality with an interest element.

An insurance company then, in order to be taxed as a Life Insurance Company, would either have to show that these regulations were invalid or that it came within the terms of the regulations.

In a former case between these parties in the said U. S. Circuit Court of Appeals for the Ninth Circuit, Docket Number 10231 (Certiorari Denied by the Supreme Court) *First National Benefit Society v. Stuart,* 134 F. (2d) 438, the first of these contentions was made, to-wit that the

Treasury Regulations were invalid, for during the years 1936, and 1937, the years involved in the said litigation, there was no State Law requiring petitioner or similar Arizona companies to maintain any reserves. It would then have been fruitless to have made any attempt to show that appellant was within the Treasury Department Regulations during the years 1936 and 1937 for the first of these qualifications did not exist. However, during the year 1937 a law was enacted by the legislature of the State of Arizona requiring a definite amount of reserves and authorizing the Corporation Commission to supervise and require sufficient reserves. (Ch. 36 Ariz. Session Laws of 1937.)

The decision of the Circuit Court of Appeals for the Ninth Circuit above referred to (see Appendix) held that the regulations were *valid.*

Since that decision and since Certiorari was denied by this Court, three United States Circuit Courts of Appeals have held that these Regulations were *invalid.*

The Fifth Circuit.

General Life Insurance Co. v. Commissioner, 137 F. (2d) 185;

Abilene Insurance Co. v. Commissioner, 137 F. (2d) 191;

American Life Ins. Co. of Texas v. Thomas, 146 F. (2d) 434.

Tenth Circuit.

Oklahoma Benefit Life Assn. v. ....., 151 F. (2d) 505.

Eighth Circuit.

Employees of Swift & Co. v. Commissioner, 151 F. (2d) 625.

However, since during the year 1938 petitioner's business was that of issuing level premium policies of Life Insurance, and since it was, during that year, required by the laws of the State of Arizona (Sec. 609 (b) Ariz. revised code of 1928, as amended), as construed by the Arizona Supreme Court (*Pioneer Mutual Benefit Ass'n v. Corporation Commission,* 123 P. (2d) 828) to maintain reserves for the fulfilment of its life insurance contracts, and since these reserves must be calculated on a basis equivalent to the American Experience Table of mortality and 3¼ per cent [Tr. Rec. 231] petitioner was a Life Insurance Company within the meaning of these regulations.

Petitioner's contention in this action was that even if the above regulations were valid, it was a Life Insurance Company within the meaning of these regulations and that the construction placed upon them by the Commissioner was contrary to the meaning of the law itself.

Statement of Basis of Jurisdiction of Supreme Court.

The petitioner, First National Benefit Society, is a corporation organized and existing under and by virtue of the laws of the State of Arizona and maintains its principal place of business in the City of Phoenix, County of Maricopa in said State. The plaintiff is and at all times herein mentioned was operating under the provisions of the Arizona Session Laws of 1937, Ch. 36, No. 1, p. 107 (Art. 6, Ch. 53 of the 1939 Ariz. Code anno.), Sec. 607-610F, Ariz. Code, anno., as amended) and respondent, W. P. Stuart, is and at all times herein mentioned, was the duly commissioned, qualified and acting Collector of Internal Revenue of the said District of Arizona.

That in January, 1939, petitioner filed in the Office of the Collector of Internal Revenue its income tax return for the year 1938.

On or about the 26th day of April, 1940, the appellant filed with the said Collector of Internal Revenue, a protest setting forth in detail the contentions of the plaintiff [Tr. Rec. pp. 7-14] and on March 31, 1941, the Treasury Department notified appellant by mail that the said protest together with statements and conferences on November 26, 1940, and February 13, 1941, had been given careful consideration and that it had been determined that plaintiff was not a Life Insurance Company within the meaning of Section 201 of the Internal Revenue Act. That it was a Mutual Insurance Company under the provisions of Section 207 thereof.

On August 12, 1941, the defendant, W. P. Stuart, Collector of Internal Revenue, demanded in writing of and from the plaintiff, in taxes and penalties the sum of $1914.05. On the 13th day of August, 1941, and in compliance with said demand and notice of intention to seize and sell the property of petitioner, the said petitioner paid to the Collector of Internal Revenue the sum of $1914.05.

On or about the 26th day of August, 1941, petitioner filed with the Commissioner of Internal Revenue, a claim for refund covering the said year, 1938, on the form prescribed by the Commissioner, for the sum of $1914.05 [Tr. Rec. pp. 15-31]. The said claim was neither rejected nor allowed and after more than six months had elapsed since the filing of said claim, and on the 11th day of April, 1942, this action was instituted to recover the said amount from the respondent.

The Complaint set forth the above matters and the respondent answered admitting that he had classified the petitioner under the provisions of Section 207 of the Internal Revenue Act. He denied that the petitioner's reserves came within the meaning of the above mentioned

regulations and pleaded that the decision in the former litigation between the said parties (No. 10231 in Circuit Court of Appeals, 134 F. (2d) 438) which held that the regulations were valid, constituted *Res Judicata* as to this action.

The Trial Court concluded that the petitioner was not a Life Insurance Company within the meaning of Section 201 (a) of the Internal Revenue Act of 1938 and that it did not have or maintain a reserve fund within the meaning of said Section as interpreted by the Regulations, and further concluded that petitioner was not entitled to a deduction under the provisions of Section 207 (c) (3) of the Revenue Act of 1938, because the matter was *Res Adjudicata* and because the premiums received by it were not "premium deposits" within the meaning of the law and because the petitioner was not a Mutual Insurance Company other than life.

Judgment was entered on June 17, 1944 and a motion for new trial was filed on June 24th, 1944 [Tr. Rec. p. 46]. Motion for new trial was denied January 8th, 1945 [Tr. Rec. p. 264]. The decision of the Circuit Court of Appeals was filed on December 11, 1945, a Motion for new trial was filed Jan. 10, 1946, and denied on January 11, 1946.

The District Court had jurisdiction of this matter under the provisions of Section 24 (5) of the Judicial Code (28 U. S. C. A. Sec. 41-5).

The Circuit Court of Appeals had jurisdiction under Section 128 (a) of the Judicial Code (28 U. S. C. A. Sec. 225-a).

The Supreme Court of the United States has jurisdiction under Section 240 of the Judicial Code (28 U. S. C. A. 347).

The Questions Presented.

1. Whether petitioner was a Life Insurance Company during the year 1938 within the meaning of Section 201 (a) of the Internal Revenue Code.

   a. Whether Treasury Dept. Regulation 94 201 (a)-1 and 203 (a)-2-1 were valid.

   b. Whether, if the regulations were valid, the petitioner was a Life Insurance Company within the meaning of those regulations.

   c. If petitioner was an insurance company other than Life, was it entitled to a deduction under the provisions of Sec. 207 (c) (3) of the Internal Revenue Code.

Reasons Relied Upon for Issuance of the Writ.

1. There is a direct conflict between the decisions of several of the Circuit Courts of Appeal.

   A. The Circuit Court of Appeals for the Ninth Circuit has held that the regulations, construing Sec. 201(a), are valid (*First National Benefit Society v. Stuart,* 134 F. (2d) 438). While three other Circuit Courts of Appeals have held that the regulations are invalid as follows:

The Fifth Circuit.

General Life Insurance Co. v. Commissioner, 137 F. (2d) 185;

Abilene Life Ins. Co. of Texas v. Thomas, 146 F. (2d) 434.

The Tenth Circuit.

Oklahoma Benefit Life Ass'n v. ....., 151 F. (2d) 505.

The Eighth Circuit.

Employees of Swift & Co. v. Commissioner, 151 F. (2d) 625.

2. There is also a direct conflict between the said Circuit Courts of Appeals in the interpretation of the said Regulations.

3. The Classification of Mutual Benefit Societies for income tax purposes is not only in conflict in the different Circuits but that classification involves hundreds of thousands of dollars over the United States, and should be determined by this court for the sake of uniformity.

4. As the situation now stands there is a discriminatory tax being collected by the Treasury Department, as between taxpayers of the different Circuits, due to the conflicting opinions of the Courts.

5. There is also a discriminatory tax being collected as between taxpayers engaged in the same business, due to different interpretations of the meaning of the regulations.

Prayer.

Wherefore, your petitioner prays that a writ of Certiorari issue under the seal of this Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding the said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals had in the case numbered and entitled on its docket No. 11039, *First National Benefit Society, a Corporation, Appellant v. W. P. Stuart, Collector of Internal Revenue, Appellee,* to the end that the said cause may be reviewed and determined by this Court as provided for by the Statutes of the United States; and that the judgment of said Court of Appeals may be reversed by this Court, and for such other and further relief as this Court may find proper.

ROBERT R. WEAVER,
Counsel for Petitioner.

Certificate of Counsel.

I, Robert R. Weaver, counsel for Petitioner herein, hereby certify that, in my judgment, the foregoing Petition for a Writ of Certiorari, is well founded, and that it is not imposed for delay.

Witness my hand this 28th day of March, 1946.

ROBERT R. WEAVER,
Attorney for Petitioner.

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Petitioner,

vs.

W. P. STUART, Collector of Internal Revenue for the District of Arizona,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of Lower Court.

1. No opinion was rendered by the District Court. Its Findings of Fact and Conclusions of Law appear at pages 36-44 of the Transcript of the Record herein.

2. The opinion of the Circuit Court of Appeals (see Appendix) in *First National Benefit Society v. Stuart,* which was pleaded herein as *Res Adjudicata* is reported in 134 F. (2d) 438.

The opinion of the Circuit Court of Appeals in the present case merely states that the Appellant had not borne the burden of proof of showing that it was a life insurance company within the meaning of Section 201(a) of the

Internal Revenue Code (see Appendix). *First National Benefit Society v. Stuart,* 152 F. (2d) 298, which could only mean that in the Court's opinion the petitioner had not shown that it was a life insurance company within the definition set out in its prior opinion as *First National v. Stuart,* 134 F. (2d) 434 (*supra*).

Statement.

a. The Statutory provisions believed to sustain jurisdiction are:

Section 24 (5) of the Judicial Code (28 U. S. C. A. Sec. 41-5);

Section 128(a) Judicial Code (28 U. S. C. A. Sec. 225 (a);

Section 240 Judicial Code (28 U. S. C. A. 347).

b. The cases believed to sustain jurisdiction of the Supreme Court of the United States are:

Warner v. New Orleans, 17 S. Ct. 892, 176 U. S. 474, 42 L. Ed. 239;

Montana Mining Co. v. St. Louis Mining & Milling Co., 27 S. Ct. 254, 204 U. S. 204, 51 L. Ed. 444.

Judgment of the Trial Court was entered June 17, 1944. Motion for new trial was filed on June 24th, 1944 [Tr. Rec. p. 46]. Motion for new trial was denied January 8th, 1945 [Tr. Rec. p. 254]. The Decision of the Circuit Court of Appeals was filed on December 11, 1945. A Motion for new trial was filed on January 10, 1946. Motion for new trial was denied on January 11, 1946.

Jurisdiction.

a. The U. S. Statutes under the jurisdiction in this matter are:

Section 240 Judicial Code (28 U. S. C. A. 347).

Statement of Facts.

During the year 1938 petitioner was engaged in the business of issuing Life Insurance contracts. It had on its books a small number of Health and Accident Policies. As of May 31, 1939, it had in all 249 Health and Accident Policies as against approximately 10,990 Life Insurance contracts [Agreed Statement of Facts, Tr. Rec. p. 50]. It was stipulated by counsel in the agreed statement of facts that no similar schedule was prepared showing the policies in force during 1938 but that there was no substantial change in the types of said policies and proportions between December 31, 1938, and May 31, 1939 [Tr. Rec. p. 50]. Approximately 98% of plaintiff's business was in the common acceptance of the term Life Insurance; that the payment upon its contracts were contingent upon death. The definition of the term Life Insurance Company as set out in the Internal Revenue Code in Section 201(a) as follows:

> "When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance) the reserve funds of which held for the fulfillment of such contracts comprise more than fifty per centum of its total reserve funds."

If the plaintiff, appellant herein, is a life insurance company, it would be taxed under the provisions of Sections 202 (a) of the Internal Revenue Act only on that income

received during the taxable year from interest, dividends and rents. In other words, on the earnings of its reserves, while if it is to be classified as a mutual insurance company other than life under Section 207 of the Act, the increment to the reserve itself would be taxed.

The Treasury Department Regulations construing the above section 201 (a)-1 and 203 (a) 2-1 limit the term "reserves held for the fulfillment of such contracts" to "reserves required by law and reserves computed or estimated with an interest element, as follows:

> "Sec. 19.201 (a)-1. Life insurance companies: Definition.—The term 'life insurance company' as used in chapter 1 is defined in section 201 (a). In determining whether an insurance company is a 'life insurance company' as defined in Section 201 (a), no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of 'reserve' contained in section 19.203 (a) (2)-1."
>
> "Sec. 19.203 (a) (2)-1. Reserve funds. In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running ex-

penses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; * * *."

The Supreme Court of the State of Arizona has held that plaintiffs reserves are required by law.

Pioneer Mutual Association v. Corporation Commissioner (123 Pac. (2d) 828).

More than 50 per centum are held for the fulfilment of its contracts. Plaintiff's Exhibit Number 2, being petitioners' balance sheet [Tr. Rec. 242]. Petitioner contends:

1. That the said regulations are invalid in that they limit and change the plain meaning of the statutes.

General Life Insurance Co. v. Commissioner, 137 F. (2d) 185;

Abilene Insurance Co. v. Commissioner, 137 F. (2d) 191;

American Life Ins. Co. of Texas v. Thomas, 146 F. (2d) 434;

Oklahoma Benefit Life Ass'n v. ....., 151 F. (2d) 505;

Employees of Swift & Co. v. Commissioner, 151 F. (2d) 625.

2. That even if valid, plaintiff is within the terms of the said regulations.

Reliance Benefit Assn. v. Commissioner of ...., 2 T. C. 15;

National Reserve Insurance Co. v. Commissioner, Docket No. 112638. March 15, 1946, not yet in reports.

Specifications of Error.

I. The Circuit Court of Appeals erred in its finding that the petitioner had not shown that it was a life insurance company.

(a) The Treasury Department Regulations (*supra*) are invalid in that they limit the meaning of Section 201 (a) of the Internal Revenue Code.

(b) Petitioner is a life insurance company within the meaning of said regulations.

(c) The court further erred in holding that if petitioner were classified under Section 207 that it would not be entitled to a deduction under the provision of Section 207 (c) (3) of the said act which refers to Mutual Insurance companies other than Life.

II. The Court erred in denying petitioner's Motion for re-hearing.

(a) Appellant's funds held for the fulfilment of its life insurance contracts constitute more than 50 per centum of its total reserve funds. Appellant's balance sheet as of December 31, 1938, Plaintiff's Exhibit 1 [Tr. Rec. p. 242] as identified in the testimony of the witness, Irma Reese, to the effect that this balance sheet was one of the regular records of the appellant.

(b) The premiums provided for appellant's policies under the law of the State of Arizona and rules promulgated by the Corporation Commission in conformity therewith, provided for a reserve equivalent to the American Experience Table of Mortality and three and one-half percentum according to the testimony of the witness, Amos Betts, Corporation Commissioner [Tr. Rec. pp. 229-232].

(c) Appellant's reserve funds were required by the law of the State of Arizona.

Pioneer Mutual Benefit Assn. v. Corp. Comm., 129 P. (2d) 829.

(d) Appellant's balance sheet shows two liabilities:

One, the mortuary reserve which constitutes more than 50 percentum of its total liabilities [Tr. Rec. p. 242]; and its expense reserve.

The segregation of any of appellant's assets, such as bank accounts or any other asset, would not affect appellant's status as its reserves are not assets but liabilities.

First National Benefit Society v. W. P. Stuart, 134 F. (2d) 438.

The insufficiency of reserves and the question of the actual receipt of interest on the amount of interest set out in the calculation is immaterial.

Lamana-Panno-Fallo Industrial Insurance Co. v. Comm., 127 F. (2d) 56;

Jones v. Oklahoma Benefit Life Assn., F. (2d) 505.

(e) It is not the purpose of the law to tax premiums received by the assured for the purpose of paying losses and expenses.

American Insurance Company of Texas v. W. A. Thomas, 136 F. (2d) 434;

Jones v. Oklahoma Benefit Life Assn., 151 F. (2d) 505.

Argument.

In this general controversy two entirely separate questions have arisen. The first is whether or not the regulations apparently limiting the definition as enacted by Congress, are valid; and the second is, if the regulations are to be regarded as valid, is the company within the provisions of the regulations as promulgated by the Commissioner. The first of these questions was litigated by the appellant and appellee herein in *First Natl. Benefit Society v. W. P. Stuart,* No. Civil 189 Phoenix, and Docket No. 10231, in this Court in which this Court decided against the appellant and was affirmed by the Circuit Court of Appeals, 134 F. (2d) 438, which held that the regulations were valid. The United States Supreme Court declined to hear the case on certiorari.

Shortly after the petition for certiorari was denied, the Fifth Circuit Court of Appeals in *General Life Insurance Company v. Commissioner of Internal Revenue,* 137 F. (2d) 185, decided that the said regulations were invalid and followed the said decision in the case of *Abilene Insurance Company v. Commissioner of Internal Revenue,* 137 F. (2d) 191. That decision was followed also by the Tax Appeals Court of the United States in *Western United Life Company v. Commissioner of Internal Revenue* and the *National Mutual Benefit Society v. Commissioner of Internal Revenue* in judgments entered August 6, 1943, Docket Numbers 108674, 110011, 108675 and 110012.

At the time of the argument of this case before the Circuit Court of Appeals, the U. S. Circuit Court of Appeals for the Tenth Circuit held that a mutual benefit association practically identical with petitioner in organization and operation to be a life insurance company within

the meaning of said Section 201 (a) (*Jones v. Oklahoma Benefit Life Association*, 151 F. (2d) 505) and shortly thereafter the U. S. Circuit Court of Appeals held that the Employees of Swift & Company was a life insurance company under the meanings of Section 201 (a).

Employees of Swift & Company v. Commissioner, 151 F. (2d) 625.

The United States Circuit Court of Appeals for the Fifth Circuit, in declaring the regulations invalid, said:

> "It is hardly conceivable that the policy of Congress was to exempt large, old line, fixed-premium life insurance companies, with its risks variedly spread over wide areas, and which had large reserves maintained by interest earnings, from taxation of premium income and to deny the benefit of the exemption to younger, smaller, and weaker life insurance companies, with their risks largely localized, and which had not yet built up a reserve in the event of serious local epidemics or disasters. To so hold would be to attribute to Congress a misdirected discrimination in favor of the strong over the weak. To give effect to Treasury Department Regulation No. 942, as construed and applied by the Commissioner, would tend to deny the benefits of the exemption to the companies that need it most. It is not thought that this was the intention of Congress."

The above mentioned case between appellant and appellee has established the law, as far as this Circuit is concerned, to be that the regulations are valid.

We are proceeding then with the question as to whether or not, for the year 1938, appellant comes within the definition as qualified by the said regulations. This question itself is in two divisions. The *first* is, were its reserves

required by the law of the State of Arizona or promulgated by the Corporation Department under authority of statute? *Second,* are fifty per centum of its reserves held for the fulfillment of its contracts, the type of reserve required by the above regulations?

We wish to take up first the question as to whether the company's reserves are required by the law of this state.

The Treasury Department Regulations, Article 203 (a)(2)-1, referred to Article 201(a)-1 of the Commissioner's Regulations and reads in part as follows:

> ". . . it must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute. . . ."

During the year 1937 a new law went into effect known as the Benefit Corporation Law of 1937 (now Section 53-601 to Section 53-622, 1939 Arizona Code Annotated), under which all the benefit societies of Arizona, including appellant, qualified in the latter part of the year 1937 as testified to by the witness Amos Betts, Chairman of the Arizona Corporation Commission [Tr. Rec. pp. 230-232].

Under the provisions of the regulations, no company could be a life insurance company unless its reserves were required by law. The above statute, as construed by our Supreme Court in *Pioneer Mutual Benefit Association v. Corporation Commission,* 123 P. (2d) 828, required that fifty per centum of its premiums, after an initial period, be placed in a mortuary or reserve fund for the benefit of its certificate holders. In this case the Court said in part:

> "The requirement that such a statement be inserted in all benefit certificates automatically creates a mort-

uary or reserve fund, because the legislature certainly did not impose this duty upon a benefit corporation and then permit it to set aside the amount named to that fund provided it saw fit to do so. . . ."

And in the same case said:

"The legislature has in the Benefit Corporation Law reposed upon the Corporation Commission the duty of seeing to it that the premiums paid for benefit certificates (insurance policies) are sufficient to pay benefit claims."

The words "insurance policies" in parenthesis above are the Court's. It is the gist of this case that the regulations of the Corporation Commission requiring a definite amount of premium are valid and that the duty to do so was imposed upon them by the aforesaid statute. The above mentioned witness testified also that when a proposed policy of any benefit corporation was submitted to the Corporation Commission for approval that they referred such policy to insurance actuaries, and that they refused to approve them (including the policies of this appellant) until they were assured that the said premium rates and reserves therein created were equivalent to the American Experience Table of Mortality and 3½ per cent interest accretions [Tr. Rec. pp. 230-322]. The same witness testified that the said Corporation Commission has promulgated a requirement that fifty per cent of the premiums provided for in such policies after the first year be set aside in the mortuary or reserve fund, and the *Pioneer Mutual case*, above referred to, holds valid this requirement of the Corporation Commission as a proper exercise of power to promulgate under the above mentioned Benefit Corporation Law.

In the aforementioned case between appellant and appellee herein, *First National Benefit Society v. W. P. Stuart,* 134 F. (2d) 438, the Court, in its original decision, had said that the law of Arizona did not require the maintenance by appellant of any reserve fund; however, a petition for rehearing was filed and *amicus curiae* brief by attorneys for a number of benefit societies who then had pending an appeal to the United States Tax Court, because a portion of the year 1937 was involved in the said suit, and the Arizona Benefit Corporation Law had gone into effect during that year. After consideration of the petition the Court entered an order modifying its original opinion as follows:

> "Good cause therefore appearing, It Is Ordered that the opinion of this court heretofore rendered and filed on March 8, 1943, be amended by striking from the first paragraph commencing on page 2 the following sentence: 'The Arizona statutes do not require the maintenance by appellant of any reserve fund.'"

This amounts to an adjudication by the Circuit Court of Appeals that subsequent to the effective date of the said statute, the laws of Arizona do require the maintenance of a reserve fund by appellant.

Although the matter was not an issue in the former case between this appellant and appellee, its reserves are now required by the laws of this state and by the requirements of the Arizona Corporation Commission, promulgated under authority of the law and in fact, under its direct mandate as interpreted by our Supreme Court in the *Pioneer Mutual Benefit Association* case, above cited.

Referring now to the *second* requirement that appellant must meet, to fall within the definition of a life insurance

company, as qualified by the above mentioned regulations of the Treasury Department, that is whether or not its reserves held for the fulfillment of its contracts are the type of reserve required by the above regulation, the statute requires that its reserves held for the fulfillment of its life insurance contracts (or combined life, health, and accident) comprises more than fifty per centum of its total reserve funds. There is no requirement in the Internal Revenue Act or the regulations that any particular percentage of the premium collected be placed in the mortuary fund, but the requirement is that of the reserves *actually held,* more than fifty per centum must be its life insurance reserves. The witness Amos Betts, Chairman of the Arizona Corporation Commission, testified that the said Commission had adopted the general policy of supervision over all benefit societies in Arizona, including appellant, to insure that the amount of funds set aside in the mortuary or reserve fund be equivalent to the American Experience Table of Mortality and 3½ per cent interest accretions, and that the policies themselves provide for the percentage of the premium collected that must go into this reserve [Tr. Rec. pp. 230-232].

The witness Irma Reese testified that she had general charge of the books of the corporation [Tr. Rec. p. 240], and that the percentage of the funds required by the Commission and provided for in the policies was daily segregated, the mortuary premiums separated from the other premiums and placed in said reserve fund [Tr. Rec. pp. 240-246]. The balance sheet introduced by appellant showing the assets and reserve of appellant on January 1, 1939, as of the close of business December 31, 1938, shows its assets as $11,058.03. It shows also the mortuary or reserve fund as $6,162.49. The same balance sheet shows as a surplus $4,895.54, which must, of necessity,

include all other reserves of the corporation. For convenience of the Court, we set out a copy of the said balance sheet as follows, the same being a part of Exhibit II in evidence herein [Tr. Rec. p. 214]:

FIRST NATIONAL BENEFIT SOCIETY

PHOENIX, ARIZONA

As at December 31, 1938

ASSETS.

Current Assets:			
Cash in Bank			$7,049.30
Deposit with State			2,000.00
Deferred Charges:			
Return Checks			2.00
Deputies' Advances			55.00
Fixed Assets:			
Furniture and Fixtures			1,951.73
			$11,058.03

LIABILITIES.

Surplus	$4,970.67		
	—75.13	$4,895.54	
Current Liabilities:			
Mortuary Income Account—Life	$70,339.73		
Claims Paid Mortuary Accounts—Life	64,177.24	$6,162.49	
Accident Reserve	2,695.77		
Accident Claims Paid	2,695.77		$11,058.03

The above regulation which we have quoted defines reserve fund within the meaning of the statute as a

> "Sum of money variously computed or estimated, which, with accretions from interest, is set aside (re-

served) as a fund with which to mature or liquidate either by payment or reinsurance with other companies future unaccrued and contingent claims."

It states also that such reserves must be required by express statutory provisions or by rules and regulations of the Insurance Department of the state. There is no requirement in the law that the reserves of a life insurance company be written upon any experience table of mortality, and likewise, there is no provisions in the Treasury Department Regulation requiring any such basis, except in the last paragraph of the said regulations in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy, issued on the weekly premium payment plan, continuing for life and not subject to cancellation.

The evidence herein in the form of all policies written by the corporation, or on the books of the corporation during the year 1938, show that appellant had no such business on its books. Even in this paragraph the only requirement is that the reserve fund be based on some recognized table of experience covering disability benefits of the kind contained in the policies; and further, this paragraph of the regulation is in regard only to a deduction when claimed under Section 203 from actual income from interest, dividends, and rents, which does not apply as to the character of reserves in the regulation itself is that it be a fund variously computed or estimated, which, with accretions from interest, be reserved as a fund for liquidation of future unaccrued and contingent claims.

This requirement has been construed in *Lamana-Panno-Fallo Industrial Insurance Co. v. Commissioner,* 127 F. (2d) 56 (United States Circuit Court of Appeals for the Fifth Circuit), as follows:

> "We are of the opinion that the revenue act, and regulation 94 construing it, do not concern themselves with the sufficiency, but only with the character of the reserves of insurance companies. It is not the function of the Commissioner to review the decision of the state insurance department as to the sufficiency of the reserves or the solvency of the company. There is no federal policy to tax discriminatorily a life insurance company whose reserve may be deficient or depleted."

In a decision dated March 15, 1946, the U. S. Tax Court in deciding that a similar Arizona Insurer was a life insurance company under Section 201(a) of the Internal Revenue Act for 1938, *National Reserve* case, *supra,* made the following statement:

> "To be entitled to classification as a life insurance company under section 201 (a) the evidence must show that petitioner's reserves held for the fulfillment of its life insurance contracts comprised more than 50 per centum of its total reserve funds. The facts show that the Arizona law and the Commission charged with the enforcement of the law, whose rules and regulations had the force and effect of law and under which petitioner operated required petitioner to place 50 percent of its premium receipts, after the first year, in a reserve fund which, with interest accretions at 3½ percent, was deemed sufficient under recognized mortality tables to protect policyholders."

The tax court in holding this company, operating in the same manner and under the same laws and with approximately the same balance sheet, to be a life insurance company did so on the basis of assuming that the regulations promulgated by the Treasury Department were valid but placed a different interpretation upon them than those contended for by the Treasury Department.

We believe that the foregoing elements which must be established by the petitioner to prove that it is a life insurance company, are plainly established by the portions of the record referred to and that the matter can be determined therefrom. Petitioner therefor requests that the decision of the U. S. Circuit Court of Appeals for the Ninth Circuit file on December 11, 1945 in its Docket No. 11039 entitled *First National Benefit Society v. W. P. Stuart,* be reverted and judgment ordered for Appellant therein.

Respectfully submitted,

ROBERT R. WEAVER,
Counsel for Petitioner.

APPENDIX.

ARIZONA REVISED CODE OF 1928.

607. BENEFIT SOCIETIES; LIMITATIONS. Associations may be formed for the purpose of paying to the nominee of any member a sum upon the death of said member not exceeding three dollars for each member of such association. No such association shall exceed in number, five thousand persons.

608. FORMATION. Such association shall be formed by filing a verified certificate in the office of the recorder of the county in which the principal place of business is to be situated, and filing a like certificate in the office of the corporation commission; such certificate shall state the general objects of the association, its principal place of business and the names of the officers selected to hold for the first three months, and shall be signed by the said officers and verified by at least three of them.

609. ASSESSMENTS. Said association, upon the death of any member, may levy an assessment, not exceeding three dollars, upon each living member, and collect and pay the same to the nominee of such deceased, and may also provide for annual assessments upon any one member not to be raised above that established at the time such member joined the association.

610. POWERS NOT CONTROLLED BY INSURANCE LAWS. Such association may sue and be sued by its name, may loan its funds and own sufficient real property for its business purposes, and such other real property as it may purchase on foreclosure of its mortgages. Such property so obtained through foreclosure shall be sold and conveyed within five years from the day title is obtained, unless the superior court of the proper county shall, upon petition

and good cause shown, extend the time. Such association may make such bylaws as may be necessary for its government and for the transaction of its business, and shall not be subject to the provisions of the general insurance laws.

CHAPTER 36, ARIZONA SESSION LAWS OF 1937.

Section 1. SHORT TITLE. This act may be cited as the benefit corporation law of 1937. (Now section 53-601, Arizona Code, 1939.)

Section 2. Section 607, Revised Code of 1928, is amended to read:

607. BENEFIT CORPORATIONS. Corporations, not for pecuniary profit, may be formed to provide cash benefits for members and cash benefits for the nominees of deceased members, and shall include all corporations, societies and associations operating an insurance business where funds are provided by mutual contributions, periodical payments, dues or assessments, except those hereinafter exempted. (Now section 53602, Arizona Code, 1939.)

Sec. 3. Sec. 608, Revised Code of 1928, is amended to read:

608. FORMATION. (a) Two hundred or more citizens of the United States, residents of this state for at least one year, may form a benefit corporation by filing articles of incorporation, verified by each of them stating the general objects of the corporation, its principal place of business, the time of its commencement and termination, the names of the directors and officers by whom the affairs of the corporation are to be conducted and the time of their election, the corporation's name (which shall indicate its general character of business and shall not closely resemble

the name of any association, life insurance company, or corporation now licensed to do business in this state), and whether private property is to be exempted from liability for the corporate debts. (Now section 53603 (a), A. C. 1939.)

(b) When the articles of incorporation have been thus filed and a certified copy thereof recorded in the office of the county recorder of the county in which its place of business is situated, and appointment of a statutory agent filed, the corporation commission shall issue the corporation a certificate of incorporation. (Now section 53-603 (b), A. C. 1939.)

Sec. 4. Article 3, Chapter 14, Revised Code of 1928, is amended by adding section 608a.

608a. MINIMUM MEMBERSHIP. Such corporation shall have twelve months from the date of its certificate of authority to secure a minimum of not less than five hundred members in good standing. Should the membership at any time fall below said minimum, the corporation shall immediately notify the corporation commission. Within ninety days thereafter, or such further time as the commission may allow, the corporation shall increase its membership to said minimum. If the corporation fails to increase its membership within the time fixed, the commission shall revoke its certificate of authority and thereupon such corporation shall liquidate and dissolve. (Now section 53-604, A. C. 1939.)

Sec. 5. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 608b:

608b. DEPOSIT OF MONEY OR SECURITY. (a) Every benefit corporation organized or operating under the provisions of this act, before receiving a certificate of authority to transact business, shall, in addition to the re-

quirements of section 609b, deposit with the state treasurer, to be by him held in trust for the benefit and protection of the corporation's members, the sum of one thousand dollars. Thereafter a further sum of one thousand dollars, divided into twelve equal monthly payments, beginning thirty days after the certificate of authority is issued, shall be likewise deposited with the state treasurer. Failure to pay any such monthly payments shall automatically cancel the corporation's certificate of authority. (Now section 53-605, A. C. 1939.)

(b) In addition to said deposits every such corporation shall, not later than February 1, 1940, and on or before February 1 of each year thereafter, deposit with the state treasurer, to be by him held in trust as hereinafter provided, for the benefit and protection of the members of the corporation, a further sum equal to one dollar for each one thousand dollars of protection in force on December 31 of the preceding year, beginning as of December 31, 1939, until a total of ten thousand dollars has been so deposited. (Now section 53-605 (b), A. C. 1939.)

(c) The deposits prescribed by this section shall be subject to withdrawal from the state treasury in whole or in part only on the order of and as directed by the corporation commission, but may, with the commission's approval, be invested in United States or state bonds, which shall be placed with and assigned to the state treasurer and held by him as provided for the original deposits. Subject to approval by the commission any such securities may be exchanged for others of like amounts. The interest on said securities shall be payable to the corporation depositing the same. (Now section 53-605 (c), A. C. 1939.)

(d) Any unsettled final judgment of a court of this state shall be a lien on the deposits of money or securities prescribed by section 608b, and subject to execution after thirty days from entry of final judgment. If said deposit is depleted thereby it shall be replenished within ninety days. (Now section 53-605 (d), A. C. 1939.)

(e) Said deposit may be considered as a part of any required reserve of the corporation and shall not be subject to withdrawal so long as the corporation has any contract or other liability outstanding. If and when the corporation liquidates, dissolves, or merges with another corporation, and there are no certificates or other liabilities not satisfied or assumed, the deposit shall be returned to the corporation upon the order of the commission, and placed to the credit of the fund from which it was taken or paid to the person who may have advanced it. (Now section 53-605 (e), A. C. 1939.)

Sec. ..... Article 3, Chapter 14, Revised Code of 1928, amended by adding section 608c:

608c. BENEFIT CERTIFICATE. (a) Every benefit certificate issued by any such corporation shall specify the maximum amount not exceeding five thousand dollars, on the life of any individual, to be paid on the happening of the contingency therein stated, and shall state the basis or amount to be set aside to the mortuary and reserve fund. The certificate, including any written amendment thereto, and, at the option of the corporation, the application therefor, and the by-laws of the corporation, shall constitute the entire contract between the corporation and the member, and the applicant shall see that all facts required to be stated are set forth in the application. (Now section 53-606 (a), A. C. 1939.)

(b) Each corporation shall provide in its certificate for at least fifteen days' grace following the due date of any periodical payment or dues, during which time the certificate shall not be forfeited. If payments are not made according to the terms of the certificate all liability of the member and of the corporation ceases, except as otherwise provided in the certificate. Any corporation may provide for a period of time, which shall be stated in the certificate, for the reinstatement of a lapsed or forfeited certificate, and for a reinstatement fee. If the corporation requires a written application for reinstatement such application shall be the basis of renewing the contract, and any statement made therein may be used by the corporation in defense of its rights under the certificate. (Now section 53-606 (b), A. C. 1939.)

Sec. 7. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 608d:

608d. FIDELITY BOND. The president, vice-president, or treasurer of every benefit corporation shall furnish a fidelity bond of a company authorized to transact business in the state, in the amount of five thousand dollars, payable to the corporation. (Now section 53-607, A. C. 1939.)

Sec. 8. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 608e:

608e. LIABILITY LIMITED. The private property of the officers, directors, members, beneficiaries, or employees of any benefit corporation organized under the provisions of this act shall not be liable for the payment of the debts of the corporation. (Now section 53-608, A. C. 1939.)

Sec. 9. Sec. 609, Revised Code of 1928, is amended to read:

609. PAYMENTS AND FUNDS. (a) Every benefit corporation shall provide in its benefit certificate for periodical payments or dues sufficient to pay benefit claims and general operating expenses as stipulated therein. (Now section 53-609 (a), A. C. 1939.)

(b) A mortuary and reserve fund, exclusive of other assets, may be created, out of which may be paid all benefit claims arising under the certificates, the deposits required to be made with the state treasurer as provided by section 608b, and attorney's fees and necessary expenses arising out of the defense, settlement, or payment of any contested or disputed claim. The residue of payments made by members, after setting aside the amount required for the mortuary and reserve fund, and interest earned by the assets of the corporation, whether deposited with the state treasurer or otherwise invested, may be used for general operating expenses. (Now section 53-609 (b), A. C. 1939.)

Sec. 10. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 609a:

609a. EXAMINATION. At least once in every two years the corporation commission shall require the books and affairs of each benefit corporation to be examined and audited by an accountant designated and commissioned by it, for the purpose of verifying the funds as provided in the benefit certificate thereof. For such purpose the commission and its auditor shall have free access to all books, papers and accounts of the corporation. The cost of any such examination and audit shall be paid by the corporation, but it shall not be required to pay for more than one such examination and audit in any one year, nor to exceed twenty-five dollars for each one thousand certificates or fraction thereof in force at the time of such examina-

tion except that a corporation chartered under the laws of another state shall also pay the traveling expenses of the accountant designated by the commission. All such costs shall be paid upon the completion of the audit or examination. (Now section 53-610, A. C. 1939.)

Sec. 11. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 609b:

Sec. 609b. CERTIFICATE OF AUTHORITY TO TRANSACT BUSINESS. (a) Before any benefit corporation shall solicit applications for benefit certificates it shall file a copy of its certificate with the corporation commission and evidence that it has made the deposit required by section 608c. If the certificate conforms to the requirements of this act, the commission shall within three days issue a written certificate of authority to the corporation to transact business. (Now section 53-611 (a), A. C. 1939.)

(b) Upon presentation to the commission of *prima facie* evidence that any benefit corporation is wilfully violating the provisions of this act, the commission shall immediately notify such corporation, stating the manner in which it is alleged the law is being violated. If it appears to the commission that the corporation is continuing such violation, it shall cite the corporation to appear within thirty days to show cause why the alleged violations should not be remedied. If upon said hearing the commission shall find that the corporation is violating the provisions of this act in the particulars stated in the citation, it shall serve a written notice of its decision upon the corporation, which shall be subject to the rights of appeal hereinafter provided. Should the corporation not appeal from such decision, or if it appeal the appellate court shall uphold the decision of the commission, the corporation shall comply with the order of the commission within ten

days thereafter, and upon its failure so to do, the commission may revoke the certificate of authority of such corporation. (Now section 53-611, A. C. 1939.)

Sec. 12. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 609c:

609c. EXEMPTION FROM ATTACHMENT. No money paid or to be paid for any benefit, as provided in a certificate issued by a corporation organized or operating under the provisions of this act, shall be liable to attachment or other process, nor may it be seized, taken, appropriated or applied by any legal or equitable process, nor by operation of law to pay any debt or liability of any member or his nominee, except as may be provided in the benefit certificate. (Now section 53-612, A. C. 1939.)

Sec. 13. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 609d:

609d. ORGANIZATIONS EXEMPTED. The provisions of this act shall not apply to secret or fraternal societies, lodges, or councils, which conduct their business and secure members on the lodge system exclusively, and having a ritualistic work and ceremonies in their societies, lodges, or councils, nor to any mutual or benefit association organized or formed and composed exclusively of members of any such society, lodge, or council, church or religious society, nor to any association of employees employed by one and the same concern, or its subsidiary, nor any labor organization, nor to any life insurance company labor organization, nor to any life insurance company organized or operating under chapter 36, Revised Code of 1928, nor to any foreign assessment company operating under the general insurance laws of this state. (Now section 53-613, A. C. 1939.)

Sec. 14. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 609e:

609e. No Vested Property Right. No member of a benefit corporation shall have any vested property right or title in any deposits or reserve during the life time of the member, other than as provided in the benefit certificate. (Now section 53-614, A. C. 1939.)

Sec. 15. Sec. 610, Revised Code of 1928, is amended to read:

610. Powers of Benefit Corporations. Any corporation organized under the provisions of this act may contract, sue and be sued by and in its own name, and shall not be subject to the provisions of the general insurance laws, and no law hereafter enacted shall apply to such corporations unless they are expressly designated therein. They may own sufficient real property for their business purposes and such other real property as they may purchase upon foreclosure of their mortgages. Property obtained through foreclosure shall be sold and conveyed within five years from the date title is obtained unless the superior court of the county in which the principal place of business of the corporation is located, shall, upon petition and for good cause shown, extend the time for such sale and conveyance. Such corporation may make and amend necessary by-laws, which shall provide for annual meetings of members who may vote in person or by proxy. The by-laws or the benefit certificate may provide for the qualification of members, mode of acceptance, the fees of admission and periodical payments or dues, the expulsion of members for non-payment of any periodical payment or dues, the restoration to membership, the employment and compensation of its agents and other regulations not in violation of this act. (Now section 53-615, A. C. 1939.)

Sec. 16. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610a:

610a. EXISTING CORPORATIONS. Any existing corporations under the provisions of sections 607, 608, 609 and 610, article 3, chapter 14, Revised Code of 1928, shall be deemed to be lawfully incorporated, organized and existing and may continue its corporate existence and transact business under, and avail itself of the provisions hereof without reincorporating or requalifying, except that such corporation shall, on or before January 1, 1938, comply with the provisions hereof as to statutory agent, minimum membership, deposits of money or securities, benefit certificate, fidelity bond, and certificate of authority, and shall be subject to examination as herein provided. (Now section 53-616, A. C. 1939.)

Sec. 17. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610b:

610b. FOREIGN ORGANIZATIONS. No benefit corporation, association, or society incorporated or transacting business under the laws of any other state or foreign country, shall transact business in this state until it complies with the requirements of this act. Any person violating any of the provisions of this section shall be guilty of a misdemeanor and upon conviction punished by a fine of not more than five hundred dollars, imprisonment in the county jail for not more than six months, or both. (Now section 53-617, A. C. 1939.)

Sec. 18. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610c:

610c. FILING FEES. The fees for the filing of instruments and documents pertaining to the organization of

benefit corporations shall be the same as the fees provided for filing of like instruments and documents with the corporation commission. (Now section 53-618, A. C. 1939.)

Sec. 19. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610d:

610d. CONTESTABILITY. (a) All certificates issued by a benefit corporation shall be incontestable after three years from their effective date or three years from the effective date of any reinstatement after lapse, except for non-payment of assessment levied.

(b) To contest the validity of a certificate, or deny liability thereunder, the corporation shall notify the member, or if the member is dead, the beneficiary, by registered letter addressed to such member or beneficiary at the last address known to the corporation. (Now section 53-619, A. C. 1939.)

Sec. 20. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610e:

610e. APPEAL. Any decision of the corporation commission may, within sixty days after the same has been served on a benefit corporation, be appealed to the superior court of the county in which the principal place of business of such corporation is located. Notice of appeal and a statement of objection to the commission's decision shall be filed with the commission, which shall, within sixty days after the appeal has been filed, transmit a copy of such notice and statement, with a certified copy of the proceedings before the commission, including a transcript of testimony and all exhibits, to the clerk of the superior court, who shall docket the appeal in the name of the

appellant as plaintiff and the corporation commission as defendant. The superior court shall hear such appeal, with or without jury, unless both parties shall file an agreement to a continuance. Either the corporation commission or any such corporation or proposed corporation may appeal from the judgment of the superior court to the supreme court. (Now section 53-620, A. C. 1939.)

Sec. 21. Article 3, chapter 14, Revised Code of 1928, is amended by adding section 610f:

610f. PENALTIES. Any solicitor, agent, examining physician, or other persons who wilfully makes any false or fraudulent statement or misrepresentation in or with reference to any application for benefit or for the purpose of obtaining any money or benefit in or to any corporation transacting business under this act, or any officer of any such corporation who refuses to permit the corporation commission or its auditor to make an examination and audit of the business, books, or records of such corporation, or who wilfully violates any of the provisions of this act shall be guilty of a misdemeanor and upon conviction shall be punished by fine of not more than five hundred dollars, imprisonment in the county jail not more than six months, or both. (Now section 53-621, A. C. 1939.)

Sec. 22. SEVERABILITY. If any provision of this act be held invalid, such invalidity shall not affect other provisions which can be given effect without the invalid provision, and to this end the provisions of the act are declared to be severable. (Now section 53-622, A. C. 1939.)

[Key, reading: West Key Number System.]

FIRST NAT. BEN. SOC. v. STUART.
No. 10231.

Circuit Court of Appeals, Ninth Circuit. March 8, 1943.

As Modified on Denial of Rehearing. April 12, 1943.

1. INTERNAL REVENUE ⇐ 2168

In action by a benefit society to recover income taxes paid, evidence sustained finding that the society did not maintain reserve for fulfillment of insurance contracts as required in order to qualify as a life insurance company within Revenue Act. Rev. Code Ariz. 1928, §§ 607-610; Revenue Act 1936, § 201, 26 U. S. C. A. Int. Rev. Acts, p. 898.

2. INTERNAL REVENUE ⇐ 826

Where benefit society did not maintain reserve for fulfillment of insurance contracts as required by treasury regulations to qualify as a life insurance company within Revenue Act, the benefit society was not taxable as a "life insurance company" but was taxable under Revenue Act imposing tax on "mutual insurance companies other than life." Rev. Code Ariz. 1928, §§ 607-610; Revenue Act 1936, §§ 201, 207, 26 U. S. C. A. Int. Rev. Acts, pp. 898, 902.

See Words and Phrases, Permanent Edition, for all other definitions of "Life Insurance Company" and "Mutual Insurance Company Other Than Life."

3. INTERNAL REVENUE ⇦ 153

Treasury regulation requiring the maintenance of reserve in order for insurance company to qualify as life insurance company within Revenue Act was not objectionable as illegal legislation where Revenue Act regarding life insurance companies was originally enacted in 1921 and successive regulations had been substantially similar since under circumstances congress was taken as having approved the administrative construction and thereby to have given it the force of law. Revenue Act 1936, § 201, 26 U. S. C. A. Int. Rev. Acts, p. 898.

4. INTERNAL REVENUE ⇦ 157

Revenue Act section defining a life insurance company as an insurance company engaged in business of issuing life insurance the reserve fund of which held for fulfillment of contracts comprised more than 50 per cent of its total reserve fund is ambiguous and justified treasury regulation regarding reserve which must be kept to qualify as a life insurance company. Revenue Act 1936, § 201, 26 U. S. C. A. Int. Rev. Acts, p. 898.

Upon Appeal from the District Court of the United States for the District of Arizona; Dave W. Ling, Judge.

Action by the First National Benefit Society, a corporation, against W. P. Stuart, Collector of internal revenue, to recover income taxes paid. Judgment for defendant, and plaintiff appeals.

Affirmed.

Robert R. Weaver, of Phoenix, Ariz., for appellant.

Samuel O. Clark, Jr., Asst. Atty. Gen., Sewall Key, Samuel H. Levy, Paul R. Hussell, and Louise Foster, Sp. Assts. to Atty. Gen., and Frank E. Flynn, U. S. Atty., of Phoenix, Ariz., for appellee.

Before Garrecht, Haney and Healy, Circuit Judges.

Haney, Circuit Judge.

Appellant sought, but was denied, recovery of income taxes alleged to be illegally exacted from it for the years 1936 and 1937, and appeals from the judgment entered in favor of appellee.

Appellant was organized under the laws of Arizona on March 29, 1934. The Articles of Incorporation provide: "That the objects and purposes for which said Corporation is formed are: To engage in, conduct and carry on the business and customary activities of a mutual benefit association within the meaning and provisions of Sections 607-608-609-610 of Chapter 14 of Article 3 of the 1928 Revised Statutes of the State of Arizona as the same now exists. * * *"

Appellant's by-laws classify its funds into three classes, although the distinction between two of them is not clear. It issues contracts of life insurance. It assesses members

to procure funds to meet claims under the contracts. Its financial statements show a very small amount of assets, but no liabilities. In other words, there was no ordinary balance statement showing assets and liabilities. Thus, these statements, being only half of the usual balance statement, disclose no reserves whatever. Such reserves as are commonly held as representing the value of the life insurance elements of the policy, are customarily shown as a liability, but appellant discloses no liabilities.

Appellant did submit operating statements which show that its receipts were classified into the various funds mentioned, but while a few show a surplus of receipts over expenditures, none of them shows that any part of such receipts were used to set up a reserve fund of any kind. Those which show a small surplus, the amount is carried in the "Asset" balance statement as such. Otherwise, the operating statements disclose that all receipts were used to pay claims and expenses. In its income tax returns for 1936 and 1937, appellant reported no tax liability but attached to the returns the statement that "The entire income consists of amounts collected from members for the sole purpose of meeting losses and expenses."

The Commissioner of Internal Revenue audited the returns and assessed tax deficiencies for both years on the theory that appellant was not a life insurance company within the meaning of § 201 of the Revenue Act of 1936, 26 U. S. C. A. Int. Rev. Acts, page 898, and it was therefore taxable under § 207 of that act. Appellant paid the tax, claimed a refund, and after denial of its claims brought this action to recover the tax paid. The court below found that appellant did not voluntarily keep, and no statute, rules or regulations promulgated in the exer-

cise of a power conferred by statute required it to keep, a reserve fund for the fulfillment of its insurance contracts. The court below concluded that appellant was not a life insurance company within the meaning of § 201 of the Revenue Act of 1936, and entered judgment for appellee. This appeal followed.

Appellant contends that it is not taxable because it is a life insurance company within the meaning of § 201 of the Revenue Act of 1936 which defines what is meant in that part of the act by the term "life insurance company" as "an insurance company engaged in the business of issuing life insurance and annuity contracts * * * the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds."

Art. 201 (a)-1, Treasury Regulations 94, provides that "no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of 'reserve' contained in article 203(a) (2)-1." The latter article provides in part as follows: "In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when

promulgated in the exercise of a power conferred by statute. * * *

"* * * A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held. * * *"

[1, 2] Appellant contends that the finding of the court below, that it maintained no reserve for the fulfillment of insurance contracts, is not sustained by the evidence. We think the finding is the only one possible under the evidence. The evidence goes no further than to show that appellant classified its income, but classifying income is not maintaining a reserve. Likewise, a requirement of the by-laws requiring maintenance of reserves does not show that appellant maintained such reserves.

[3, 4] The statute, itself, does not expressly require a reserve before a company can be considered a "life insurance company." Likewise it does not say that if reserves are kept, they must be of the kind which are required by statute. However, the statute does not provide to the contrary either. The regulations require a reserve, and the kind of reserve specified by the state statutes or regulations promulgated thereunder. Appellant argues that the regulations, in so defining, if not limiting, the scope of the statute, have illegally legislated by changing the classification of tax payers. It is not argued that Congress could not have done what the regulations did, but it is argued that Congress has not done so.

The statute as quoted above was originally enacted in 1921. It has existed since without change. The successive regulations have been substantially similar. Under these circumstances "Congress must be taken to have approved the administrative construction and thereby to have given it the force of law." Helvering v. Raynolds Co., 306 U. S. 110, 115, 59 S. Ct. 423, 426, 83 L. Ed. 536. See, also, Helvering v. Winmill, 305 U. S. 79, 83, 59 S. Ct. 45, 83 L. Ed. 52, and cases cited in note 7. Appellant maintains that the statute is unambiguous, and that it comes within its plain terms, and therefore the regulations cannot limit the statute. We do not regard the statute as unambiguous. The statute itself certainly does not make it clear whether any reserve must be kept, and it does not make it clear that if reserves are kept they must or must not be of the kind required by state law to be kept. While it might be possible to look at various provisions of the act and its legislative history, and thus determine what Congress should have meant in logic, we are not determining what Congress should have meant, but what it actually meant.

Affirmed.

In the United States Circuit Court of Appeals for the Ninth Circuit.

First National Benefit Society, a corporation, Appellant, vs. W. P. Stuart, Collector of Internal Revenue, Appellee. No. 11,039. Dec. 11, 1945.

Appeal from the District Court of the United States for the District of Arizona.

Before GARRECHT, MATHEWS and HEALY, Circuit Judges. MATHEWS, Circuit Judge.

For the calendar year 1938, appellant filed an income tax return which disclosed no income nor any income tax liability. The Commissioner of Internal Revenue determined that appellant was a mutual insurance company (other than a life insurance company) within the meaning of § 207(a) of the Revenue Act of 1938,[1] 26 U. S. C. A. Int. Rev. Acts, p. 1092, and hence was taxable under that section, and that it had special class net income of $10,139.48 in 1938 and hence owed a tax of $1,673.01 (16½% of $10,139.48). The tax was assessed by the Commissioner and was collected by appellee, Collector of Internal Revenue for the District of Arizona. A claim for refund was duly filed with the Commissioner. No decision thereon having been rendered within six months from the date of such filing, appellant brought a suit against appellee for the recovery of the tax.[2] Appellee answered, trial was

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[1]Section 207(a) provides: "There shall be levied, collected, and paid for each taxable year upon the special class net income of every mutual insurance company (other than a life insurance company) a tax equal to 16½ per centum thereof." For the meaning of the term "special class net income," see § 14(a) of the Revenue Act of 1938, 26 U. S. C. A. Rev. Acts, p. 1006.

[2]26 U. S. C. A. Int. Rev. Code, § 3772.

had, findings of fact and conclusions of law were stated, and judgment was entered in favor of appellee. From that judgment this appeal is prosecuted.

Appellant alleged, in substance and effect, that it was a life insurance company within the meaning of § 201(a) of the Revenue Act of 1938,[3] 26 U. S. C. A. Int. Rev. Acts, p. 1087, and hence was not taxable under § 207(a). Appellee denied that appellant was a life insurance company within the meaning of § 201(a). On this issue, appellant had the burden of proof.[4] Thus appellant had the burden of proving that it was engaged in the business of issuing life insurance and annuity contracts, and that its reserve funds held for the fulfillment of such contracts comprised more than 50% of its total reserve funds.[5] The burden was not sustained. The court properly concluded that appellant was not a life insurance company within the meaning of § 201(a).[6]

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[3]Section 201(a) provides: "When used in this title [§§ 1-373 of the Revenue Act of 1938, 26 U. S. C. A. Int. Rev. Acts, pp. 1001-1129] the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds."

[4]United States v. Anderson, 269 U. S. 422; United States v. Mitchell, 271 U. S. 9; Botany Worsted Mills v. United States, 278 U. S. 282; Reinecke v. Spaulding, 280 U. S. 227; McLaughlin v. Pacific Lumber Co., 293 U. S. 351; Welch v. St. Helens Petroleum Co., 9 Cir., 78 F. 2d 631; Obispo Oil Co. v. Welch, 9 Cir., 85 F. 2d 860; Parrott Estate Co. v. McLaughlin, 9 Cir., 89 F. 2d 189; Maloney v. Western Cooperage Co., 9 Cir., 103 F. 2d 992; United States v. Trust No. B. I. 35, 9 Cir. 107 F. 2d 22; Powell v. United States, 9 Cir., 123 F. 2d 4572; Cranson v. United States, 9 Cir., 146 F. 2d 871.

[5]See footnote 3.

[6]Cf. First National Benefit Society v. Stuart, 9 Cir., 134 F. 2d 438.

Appellant alleged, in substance and effect, that, if taxable under § 207(a), it was entitled to a deduction under § 207(c)(3) of the Revenue Act of 1938,[7] 26 U. S. C. A. Int. Rev. Acts, pp. 1092, 1093. Appellee denied that appellant was entitled to any such deduction. On this issue, appellant had the burden of proof.[8] Thus appellant had the burden of proving that its members were required to make premium deposits to provide for losses and expenses and that some amount thereof was returned to its policyholders or was retained for the payment of losses, expenses and reinsurance reserves.[9] The burden was not sustained. The court properly concluded that appellant was not entitled to a deduction under § 207(c)(3).

Judgment affirmed.

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[7]Section 207(c) provides:

"(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

"(3) Mutual insurance companies other than life and marine. —In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves."

[8]See cases cited in footnote 4.

[9]See footnote 7.

(Endorsed.) Opinion. Filed Dec. 11, 1945. Paul P. O'Brien, Clerk.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of April, A. D. 1946.

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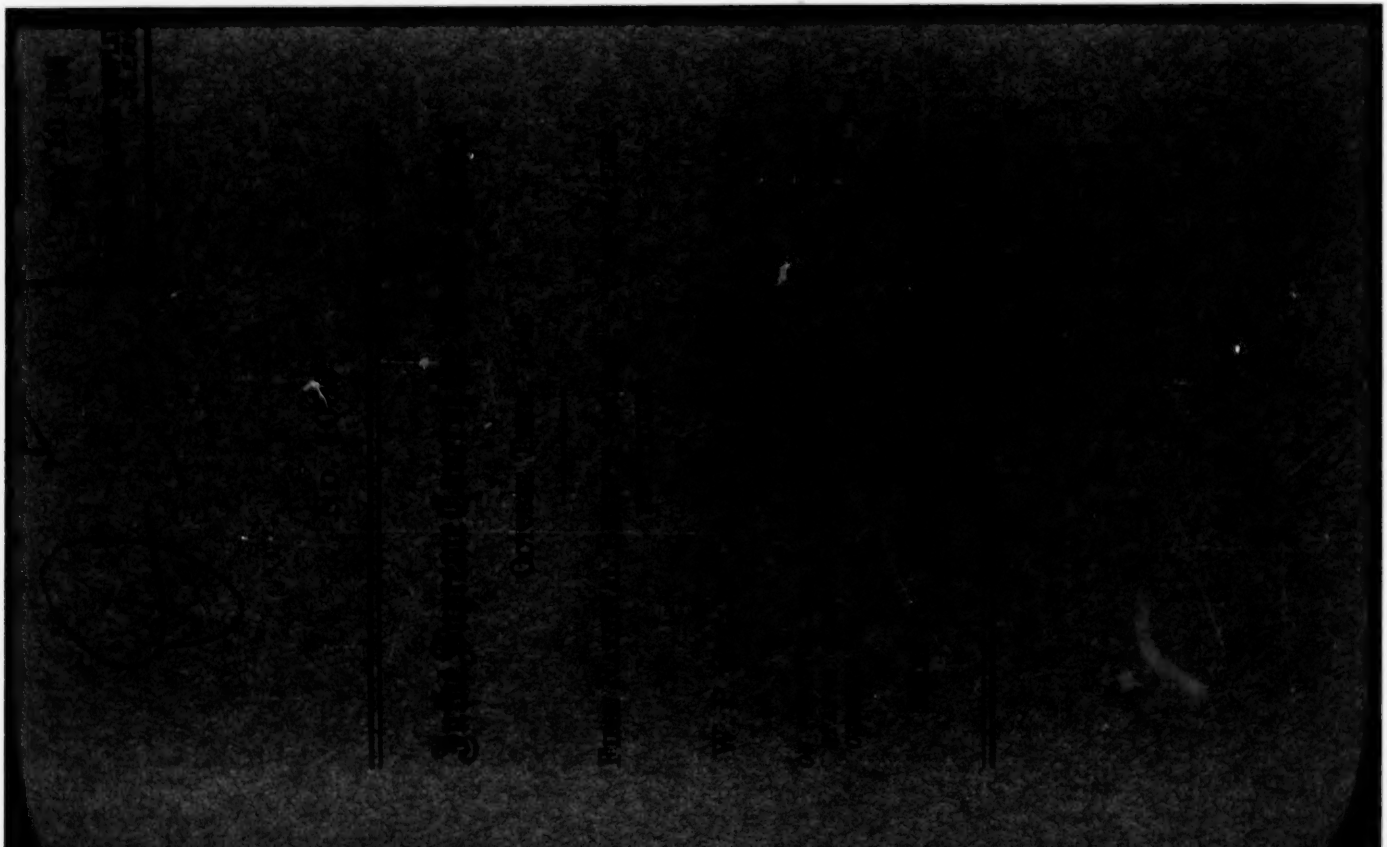

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 1065

FIRST NATIONAL BENEFIT SOCIETY, A CORPORATION, PETITIONER

v.

W. P. STUART, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The District Court for the District of Arizona wrote no opinion. Its findings of fact and conclusions of law are found in the record at pages 36–44. The opinion of the Circuit Court of Appeals (R. 290–293) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 11, 1945. (R. 293–294.) A petition for rehearing was denied on January 11, 1946. (R. 294.) A petition for writ of certiorari was filed on April 5, 1946. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer, during the calendar year 1938, was a life insurance company, as defined by Section 201 (a) of the Revenue Act of 1938.

2. If not, whether the taxpayer is entitled to additional deductions for premium deposits under Section 207 (c) (3) of the Revenue Act of 1938.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts found by the District Court may be summarized as follows:

The taxpayer was incorporated in 1934, under the laws of Arizona as a mutual benefit association. Its primary purpose was to provide funds for the burial of deceased members. Seven classes of certificates or policies outstanding in 1938 totaled approximately 10,000. The benefits or insurance in force aggregated approximately $3,765,595 on December 31, 1938. (R. 36–37.)

The financial statement attached to the taxpayer's return showed the following as of December 31, 1938 (R. 37):

ASSETS

Cash	$7,049.30
Deposit with state	2,000.00
Furniture and fixtures	1,951.73
Deferred charges	57.00
Total	$11,058.03

LIABILITIES

Surplus	4,895.54
Mortuary income account—life	6,162.49
Total	$11,058.03

The taxpayer kept a bookkeeping record allocating a portion of its premium receipts to the "mortuary reserve," but it maintained only one bank account and the deposits were not segregated. The general fund, under the by-laws, was to be used for expenses not payable out of the mortuary fund, and the mortuary fund was to be used for the payment of claims, taxes, attorney's fees, the deposit required by the State of Arizona, and such expense charges as should be fixed by the board of directors for the handling of claims. The certificates recited the by-law provision requiring 50% of premiums after the first year be deposited in a reserve fund. (R. 38.)

Taxpayer was managed during 1938 and prior years by M. C. Reese, his wife, and a brother, who were president, vice-president, and secretary-treasurer, respectively. These also constituted the board of directors. Two directors constituted a quorum for the transaction of business and the by-laws could be altered at any meeting by a two-thirds vote of the directors. The directors were em-

powered to appoint and remove at pleasure all officers and employees and could expel any member at any time for any cause sufficient in their judgment with or without notice to such member. Funds were dispensed upon the check of M. C. Reese as president. Officers' salaries aggregated $7,500 in 1936, $9,750 in 1937, and $15,900 in 1938. The latter compensation was paid $13,500 to M. C. Reese and $2,400 to his brother. These officers received travel allowances of $2,200 in 1936, and $2,400 in 1937 and in 1938. From these facts the District Court concluded that it was inferable that the taxpayer was operated for the benefit of the controlling director-officers rather than for the purpose of providing insurance to its members at cost. (R. 40.)

Membership in the taxpayer was not limited under its by-laws to persons holding benefit certificates; it was permissible to acquire membership, to vote and to hold office upon payment of certain minimum dues, and agents soliciting memberships could become "Honor" members entitled to any entertainment privileges or the use of any lodge or other headquarters maintained by the taxpayer. (R. 41.)

The facts and question in this case are substantially the same as those previously decided by the Federal District Court for the District of Arizona in *First National Benefit Society* v. *Stuart,* on March 4, 1942 (30 A. F. T. R. 1659), affirmed, 134 F. 2d 438 (C. C. A. 9th), certiorari

denied, 320 U. S. 211, relating to the taxpayer's income tax liability for 1936 and 1937. (R. 42.)

The Commissioner determined that the taxpayer's taxable net income for 1938 was $10,139.48 and that its income tax liability was $1,673.01. The taxpayer paid the tax assessed by the Commissioner, together with interest, on August 13, 1941, in the aggregate sum of $1,914.05, and thereupon filed a claim for refund of the tax and interest. After more than six months had elapsed without action on the claim by the Commissioner, taxpayer brought the instant suit. (R. 39.)

In its conclusions of law, the District Court held that the taxpayer did not maintain a "reserve fund" for the sole purpose of fulfilling its insurance contracts within the meaning of Section 201 (a) and the applicable Treasury Regulations. It also concluded that the deductions claimed under Section 207 (c) of the Revenue Act of 1938 were not allowable under the principle of *res judicata,* and that even if the principle were inapplicable, the taxpayer was not entitled to additional deductions for 1938 because the premiums received by it were not "premium deposits." The court concluded finally that the taxpayer had failed to sustain the burden of proving error on the part of the Commissioner. (R. 42–44.) The Circuit Court of Appeals affirmed on the ground that on neither issue had the taxpayer sustained its burden of proof. (R. 290–293.)

ARGUMENT

1. On the issue whether the taxpayer was a life insurance company within the meaning of Section 201 (a) of the Revenue Act of 1938 (Appendix, *infra*) the Circuit Court of Appeals held that the taxpayer had not sustained its burden of proving that it was within the statutory definition. (R. 292.) Those provisions require that a life insurance company must be:

> engaged in the business of issuing life insurance and annuity contracts, * * * the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

It cannot be denied, and the taxpayer does not undertake to do so, that it had the burden of proving the Commissioner's determination incorrect. *Reinecke* v. *Spalding,* 280 U. S. 227; *Botany Mills* v. *United States,* 278 U. S. 282; *United States* v. *Anderson,* 269 U. S. 422. In this posture no question arises as to the validity of Article 203 (a) (2)–1 of Treasury Regulations 101 (Appendix, *infra*), and the asserted conflict based on decisions of the Fifth, Eighth and Tenth Circuit Courts of Appeals invalidating portions of the regulation (Pet. 7–8) is unfounded.

The statute requires that reserve funds held for the fulfillment of life insurance contracts constitute fifty percent of its total reserve funds. Whatever in addition the term "reserve funds" may mean, as defined in the Regulations, the least

that the phrase, as used in the statute, requires is that a sum of money be set aside, "reserved," as a fund to meet obligations arising out of the insurance policies issued by the taxpayer. This was the meaning assigned to "reserve" by this Court in *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 350. The Fifth Circuit relied on this definition in interpreting the phrase, in a statute identical with the one involved here, and in arriving at the conclusion that the reserve must be a fund irrevocably set aside for the protection of the policy holders. The court concluded that "in a sense" the reserve "partakes of the nature of an inchoate trust for the benefit of policy holders." *General Life Ins. Co.* v. *Commissioner,* 137 F. 2d 185, 189, 190.

That there was no fund irrevocably set aside here for the protection of the policy holders is clear. The District Court found that although a bookkeeping record was kept allocating a portion of its premium receipts to the "mortuary reserve," the company maintained only one bank account and deposits were not segregated. Moreover, under the by-laws, the "mortuary fund" was to be used for the payment of claims, taxes, attorneys fees, the deposit required by the State of Arizona and such expense charges as should be fixed by the board of directors for the handling of claims. (R. 38.) The Court concluded that the taxpayer did not maintain a "reserve fund" and even if it had, the fund could be used for

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purposes other than the fulfillment of insurance contracts as required by Section 201 (a). (R. 43.) This uncontested conclusion is amply supported by the record, and on familiar principles is conclusive on review. *McCaughn* v. *Real Estate Co.*, 297 U. S. 606.

Although the Circuit Court of Appeals in this case did not rely on the Treasury Regulations, they furnish additional support for the decision herein. Article 203 (a) (2)–1, Regulations 101, provides:

> In general, the reserve contemplated is a sum of money, variously computed or estimated, which, * * * is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims.

These provisions are patterned after the definition contained in *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 350. This interpretation adopted in the Regulations is reasonable. Its validity is confirmed by the successive re-enactments of the Revenue Acts [1] (see *Helvering* v. *Winmill*, 305 U. S. 79, 83), and no court has challenged it.

The alleged conflict posed by *General Life Ins. Co.* v. *Commissioner, supra; Abilene Life Ins.*

[1] Article 203 (a) (2)–1 of Treasury Regulations 94 and 86 under the 1936 and 1934 Acts, respectively, are the same. Similar provisions have appeared in all Regulations since the enactment of the Revenue Act of 1921. See Article 681 of Treasury Regulations 62, 65 and 69; Article 971 of Treasury Regulations 74 and 77.

Co. v. *Commissioner,* 137 F. 2d 191 (C. C. A. 5th); *Jones* v. *Oklahoma Ben. Life Ass'n,* 151 F. 2d 505 (C. C. A. 10th), and *Swift & Company Employes Benefit Ass'n* v. *Commissioner,* 151 F. 2d 625 (C. C. A. 7th), does not exist. The *General Life* case threw doubt on the validity of the regulation's actuarial requirements for a reserve fund but as we have already shown the Court stated that the fund was in the nature of a trust and accordingly the case supports the result of the court below. The companion *Abilene* case was decided on the same basis. *Oklahoma Benefit Life* was expressly limited to the question whether interest which did not accrue to the reserve fund is a use of the fund other than for the payment of claims arising out of the policies and the *Swift and Company Employees* case turned solely on the requirement of the regulation that the reserve be required by law.

Finally, the question of the validity of the entire regulation, even were it presented by this case, is of diminishing importance because its provisions were largely adopted in the definition of "life insurance reserves" in Section 201 (c) (2) of the Internal Revenue Code, added by Section 163 (a) of the Revenue Act of 1942.

2. Taxpayer lists as a question presented whether it is entitled to a deduction under Section 207 (c) (3) (Pet. 7) of the Revenue Act of 1938 (Appendix, *infra*), but no reason is assigned for

issuance of the writ on this issue (Pet. 7–8) and none appears in the supporting brief. We believe there are none. Even were there otherwise sufficient reason for issuance of the writ, it should not be issued in this case because the same issue was litigated between the parties to this case for 1936 and 1937 in *First Nat. Ben. Soc.* v. *Stuart,* 134 F. 2d 438 (C. C. A. 9th), certiorari denied, 320 U. S. 211 (R. 42, 43) and accordingly is *res judicata. Tait* v. *Western Md. Ry. Co.,* 289 U. S. 620.

CONCLUSION

There is no conflict of decisions and the decision of the court below is correct. The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. HOWARD MCGRATH,
Solicitor General.

SEWALL KEY,
Acting Assistant Attorney General.

ROBERT N. ANDERSON,
IRVING I. AXELRAD,
Special Assistants to the Attorney General.

MAY 1946.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) *Definition.* When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents. For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General Rule.* In the case of a life insurance company the term "net income" means the gross income less—

(1) *Tax-free interest.* * * *

(2) *Reserve funds.* An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) *Reserve for dividends.* * * *

(4) *Investment expenses.* * * *

(5) *Real estate expenses.* * * *

(6) *Depreciation.* * * *

(7) *Interest.* * * *

* * * * *

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Imposition of Tax.*

(1) *In general.* There shall be levied, collected, and paid for each taxable year upon the special class net income of every mutual insurance company (other than a

life insurance company) a tax equal to 16½ per centum thereof.

* * * * *

(c) *Deductions.* In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual insurance companies other than life insurance.* In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * *

(3) *Mutual insurance companies other than life and marine.* In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 201 (a)–1. *Life insurance companies: Definition.* The term "life insur-

ance company" as used in Title I is defined in section 201 (a). In determining whether an insurance company is a "life insurance company" as defined in section 201 (a), no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of "reserve" contained in article 203 (a) (2)–1.

* * * * *

ART. 203 (a) (2)–1. *Reserve funds.* In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been

waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ percent of the mean of such reserve funds held at the beginning and end of the taxable year.

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